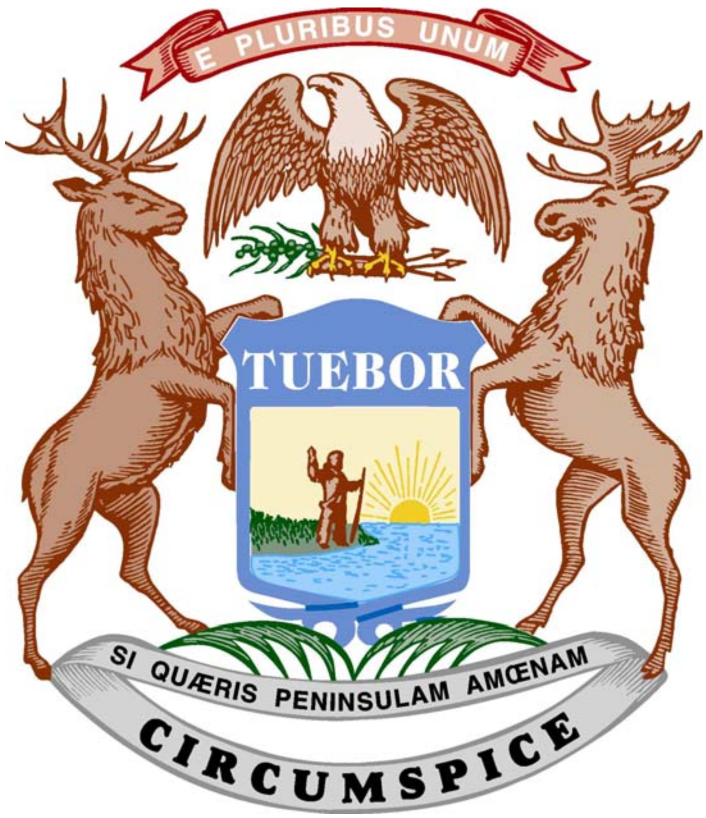
Michigan Economic and Revenue Outlook

FY 2004-05 and FY 2005-06



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May 19, 2005

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EXECUTIVE SUMMARY
May 19, 2005

Revenue Review and Outlook

- FY 2004 GF-GP revenue increased to $8,041.8 million, a 1.0 percent increase over FY 2003. School Aid Fund (SAF) revenue fell 0.9 percent to $10,615.5 million. The change in the timing of the state education tax payments increased FY 2003 SAF revenues, and as a result reduced the FY 2004 SAF growth rate. Excluding the state education tax shift, FY 2004 SAF revenues were 3.4 percent higher than FY 2003.

- FY 2005 GF-GP revenue is projected to decline 1.8 percent to $7,894.2 million. This total is $24.4 million above the January 2005 Consensus estimate. SAF revenue is projected to increase 2.5 percent to $10,885.7 million, $6.9 million more than the January 2005 Consensus estimate.

- FY 2006 GF-GP revenue is forecast to increase 3.3 percent to $8,156.0 million. This total is essentially unchanged from the January 2005 Consensus estimate and represents a $261.8 million increase over the FY 2005 total. FY 2006 SAF revenue is forecast to grow 3.7 percent to $11,291.7 million. This represents a decline of $9.2 million from the January 2005 Consensus estimate and an increase of $406 million over the FY 2005 level.

2005 and 2006 U.S. Economic Outlook

- Real gross domestic product growth is forecast to average 3.3 percent in 2005 and 2.9 percent in 2006, after increasing by 4.4 percent in 2004.

- Employment is projected to continue growing over the forecast horizon. The U.S. unemployment rate is forecast to average 5.3 percent in both 2005 and 2006.

- Historically low interest rates have provided consumers with the ability to purchase housing at record levels and refinance existing mortgages. However, with wage and commodity price pressures building, interest rates are projected to increase throughout the forecast period.

- Real consumption is forecast to grow 3.5 percent in 2005 and 3.4 percent in 2006. Real business fixed investment is projected to increase 6.4 percent in 2005 and 7.0 percent in 2006.

- Light vehicle sales are forecast to be 16.6 million units in 2005 and 16.6 million units in 2006, down just slightly from 2004.

- Consumer price inflation is forecast to be moderate, averaging 2.6 percent in 2005 and 2.7 percent in 2006.

2005 and 2006 Michigan Economic Outlook

- Michigan wage and salary employment is forecast to grow modestly throughout the forecast period. In 2005, Michigan wage and salary employment is forecast to fall 0.1 percent before increasing 0.8 percent in 2006.
- In 2005, the Michigan unemployment rate is forecast to rise to 7.3 percent in 2005 before declining to 7.0 percent in 2006.
- Wage and salary income is forecast to increase 3.4 percent in CY 2005 and 4.3 percent in CY 2006. Personal income will post moderate increases throughout the forecast horizon. In 2005 and 2006, personal income is forecast to rise 4.5 percent and 5.4 percent, respectively.
- In FY 2005 and FY 2006, Michigan wage and salary income is expected to grow 3.3 percent and 3.8 percent. Disposable income is expected to rise 3.9 percent and 4.8 percent in FY 2005 and FY 2006, respectively.

Forecast Risks

There is both a downside and an upside risk to the assumption that oil prices remain around $50 a barrel. Geopolitical concerns may lessen/intensify, reducing (increasing) oil prices. Recent high oil prices may slow the world economy leading to a reduction in the demand for oil. A lower/higher oil price will help boost retard/domestic growth.

The baseline forecast assumes that the value of the dollar will continue to fall in an orderly fashion. However, if international confidence in the dollar declines dramatically, the value of the dollar may fall sharply. A plummeting dollar could roil financial markets, sharply curtailing both consumption and investment and thus slow economic growth sharply. A collapsing dollar would also put upward pressure on inflation and possibly lead to still higher interest rates, which would further retard growth. Higher interest rates may slow consumption more than forecasted.

The forecast uses a five-country trade weighted growth rate that does not include many faster growing countries that are becoming more significant trading partners. Given this, there is an upside risk regarding rest of world growth. On the other hand, higher oil and other commodity prices could retard rest of world growth.

Firms' increased pricing power, increased obsolescence of current capacity, higher commodity prices, and rising health care and pension costs may lead to higher inflation than the baseline forecast projects. This higher inflation rate may crimp consumption and investment spending – especially if accompanied by even more aggressive inflation fighting on the part of the Federal Reserve.

If business investment is above projected levels, economic growth may be more than forecast. For the Michigan economy, Big Three market share is important. Similarly, faster/slower productivity growth may decrease/increase employment. Faster/slower inventory investment will increase/decrease economic growth.

ECONOMIC REVIEW AND OUTLOOK
May 19, 2005

Current U.S. Economic Situation

Summary

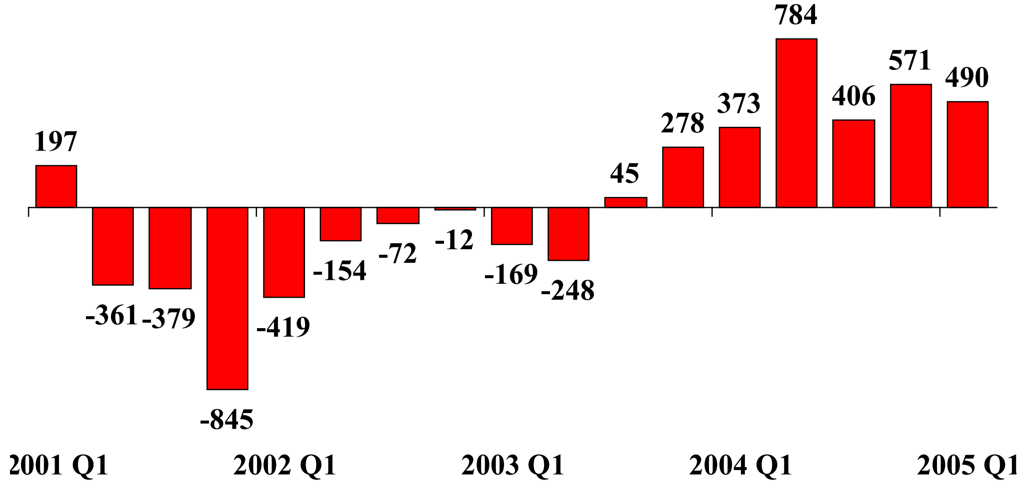
In the first quarter of 2005, real GDP growth slowed to a 3.1 percent rate. While marking the eighth straight quarter that growth exceeded 3.0 percent, first quarter growth was the slowest since the first quarter of 2003. Slowed by higher gasoline prices, real consumption growth slowed to 3.5 percent. Durable consumption growth was flat. Real fixed investment growth, slowed by both higher oil prices and the expiration of investment tax incentives, fell to 5.0 percent, the slowest growth rate in a year. While real exports rose at a 7.0 percent rate, real imports grew at more than twice that rate. In addition, real inventories rose sharply, increasing by their largest amount since the second quarter of 2000. This rapid increase suggests that a substantial amount of inventory growth may have been unintended, boding slower growth moving forward. At a 16.4 million annual rate, first quarter light vehicle sales remained at historically high levels. However, the 16.4 million rate represented the slowest rate since the second quarter of 2003.

While having lagged the overall recovery, employment has increased each month since mid 2003. Over the past four quarters, payroll employment has increased by an average of 570,000 jobs. Over the first four months of 2005, employment has risen by an average of 211,000 jobs. As a result of recent employment growth, U.S. employment now exceeds its pre-recession peak. However, manufacturing employment remains substantially below its own pre-recession peak.

Beginning in June 2004, the Federal Reserve Open Market Committee has increased the target federal funds rate 25 basis points at each of its meetings. At its May 2005 meeting, the Committee raised the target rate for the eighth time, increasing the rate to 3.00 percent. In response to the Committee's actions, short-term rates have risen but nonetheless remain at historically low levels. Long-term rates have actually fallen since the Committee began increasing the target federal funds rate. Oil prices are down from record highs earlier this year. Nevertheless oil prices, responding to strong demand, limited supplies and geopolitical risks, remain around $50 a barrel.

After posting solid growth through the middle of 2005, real federal government spending is expected to slow with real spending flat in 2006. On the other hand, state and local government spending, whose growth has been anemic, is expected to gain strength and post moderate growth beginning in the second half of this year.

US Payroll Employment Growing
(Quarterly Change in Thousands)

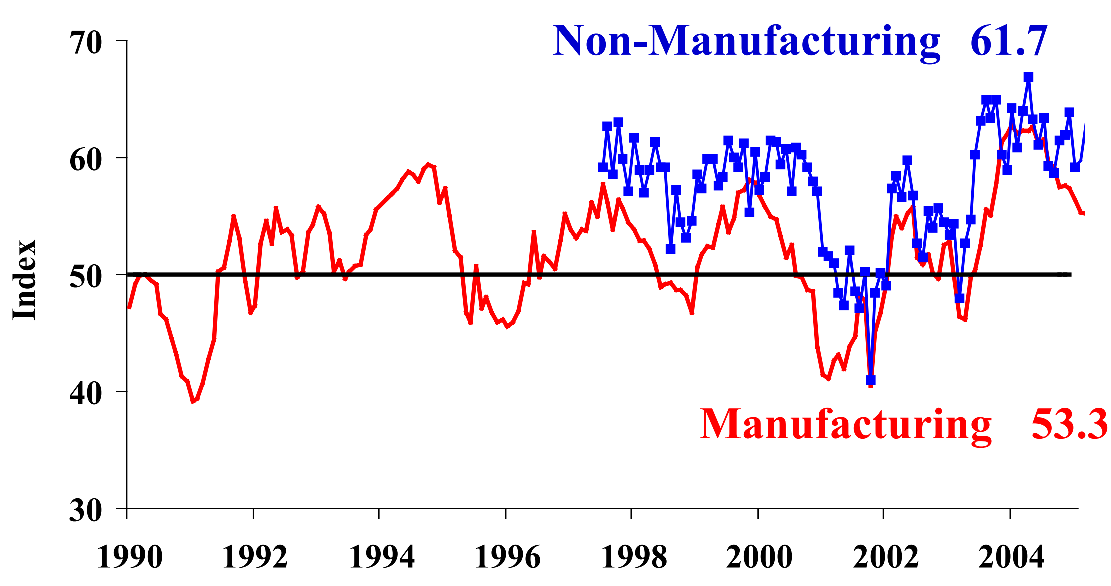


Source: U.S. Bureau of Labor Statistics

<u>Major Economic Indicators</u>

Major U.S. economic indicators point to continued, but likely slowing, economic growth. The Institute for Supply Management's (ISM) manufacturing index has signaled growth each month since mid 2003. However, the index has been below 60 for nine straight months and has declined recently. The ISM non-manufacturing index has performed better. The index has signaled non-manufacturing growth since April 2003 and has been above 60 the last two months. A reading of 50 indicates a growing sector.

ISM Indices Signal Growth in Manufacturing and Services



Source: Institute for Supply Management.

For nearly two years, new orders for durable goods have roughly trended upward. However, new orders declined substantially in March 2005 suggesting moderating economic growth. March new durable goods orders were down 1.1 percent from a year ago. Capacity utilization is up 2.0 percentage points from a year ago. After having flattened out, utilization has reported solid gains recently.

March 2005 retail sales were up 8.6 percent from a year ago. Consumer sentiment declined for the fourth straight month in April as higher energy prices weighed on sentiment. Sentiment declined sharply in April, falling from 92.6 to 87.7. The ABC News/Washington Post consumer comfort index, which measures consumers' attitude toward current economic conditions, has flattened out after having fallen.

In March, the index of leading economic indicators fell for the second time in the last three months.

Employment

U.S. employment has now increased every month since June 2003. Over the first four months of this year, employment has increased by 211,000 jobs per month. In April, employment rose by 274,000 jobs. Over the past year, employment is up by 2.2 million jobs (1.7 percent). With these gains, U.S. employment is now nearly 750,000 jobs above its pre-recession peak.

However, manufacturing employment remains hard hit. In April, manufacturing employment was 3.3 million jobs (18.9 percent) below its 1998 pre-recession peak. Over the past year, while overall employment has increased, manufacturing employment has been flat. Further, April employment in the motor vehicle and parts sector was down 1.5 percent from a year ago. Compared to its 2000 pre-recession peak, motor vehicle and parts employment is down 17.4 percent. Rapid productivity gains allowed firms to reduce payroll employment even as they continued to increase output.

U.S. employment indicators are stronger and indicate that employment should continue to rise. Compared to a year ago, initial unemployment claims have fallen from around 340,000 to around 320,000 (four week moving average). Initial claims trended downward over the first two months of 2005 with the four-week moving average falling below 310,000. Claims then rose to nearly 340,000 before falling to 320,000 in recent weeks.

The Institute for Supply Management's (ISM) manufacturing employment index component has shown expansion each month since late 2003. However, the index has fallen for three straight months and is now at its lowest level since November 2003. The non-manufacturing ISM employment index has signaled expansion each month since October 2003. However the index has fallen two straight months. In April, the Challenger Report count of announced layoffs fell sharply to its lowest level since November 2000 to 58,000, down from an average of 100,000 over the prior six months. Overall layoff announcements were down nearly 20 percent from a year ago.

Weekly hours worked, a leading indicator for employment, have remained flat for nearly half a year before rising 0.2 hours in April. Compared to a year ago, hours worked are up 0.2 hours.

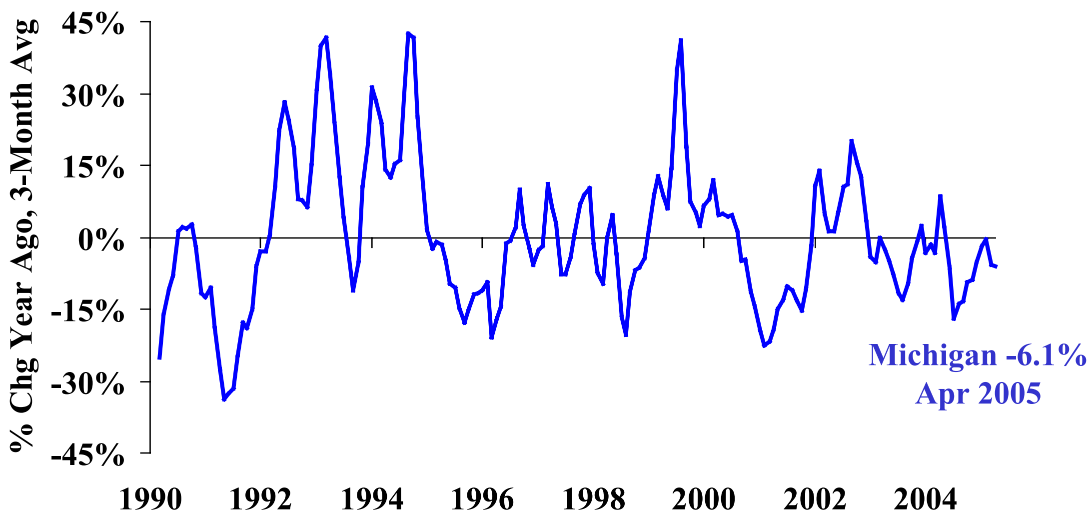
Vehicle Sales and Production

Rebates coupled with low financing rates have helped maintain vehicle sales above 16 million units. At a 16.4 million annual rate, first quarter light vehicle sales remained at historically high levels. However, the 16.4 million rate represented the slowest rate since the second quarter of 2003.

Over the past few years, imports and transplants have continued to increase their market share. The traditional Big Three market share has continued to fall, with their share at 58.7 percent for 2004, a record low.

Averaged over the past three months, U.S. vehicle production in April 2005 was down 3.9 percent from a year ago, compared with a 6.1 percent decline in Michigan.

Michigan Vehicle Production Down from Year Ago



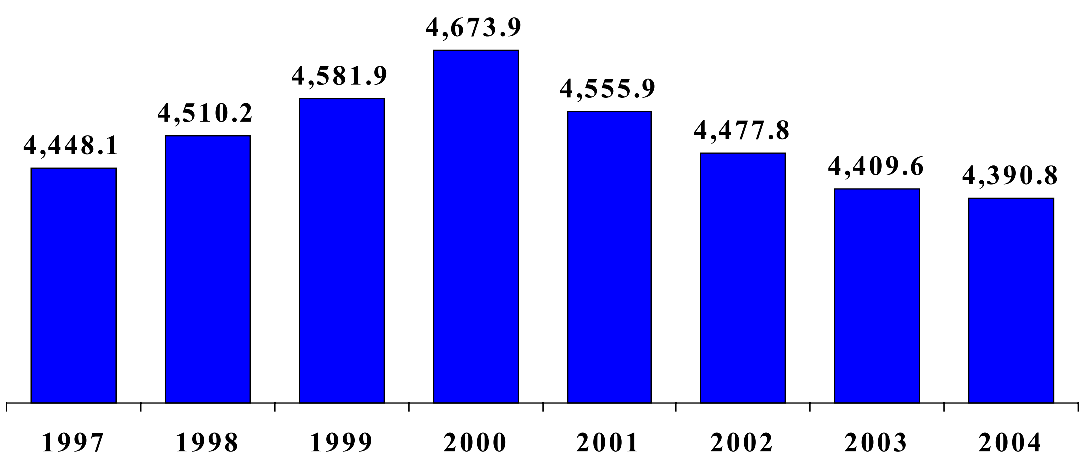
Source: Michigan Department of Treasury and Automotive News.

Current Michigan Economic Conditions

Employment

Michigan's economy relies heavily on the performance of the manufacturing sector in general and the auto industry specifically. Given extremely weak manufacturing employment performance, declining vehicle production, continued declines in Big 3 market share along with continued supply rationalization among vehicle suppliers, Michigan's employment performance has been below the national average. Substantial productivity gains in the vehicle industry have also contributed to Michigan's sub-par employment performance. Over the past four years, the annual average for wage and salary employment has fallen. However, these declines have slowed across time. From Michigan's employment peak in June 2000 compared to March 2005, Michigan has lost 317,400 jobs. By this time after the 1990-1991 recession, Michigan employment had risen by about 250,000 jobs *above* its pre-recession peak.

Michigan Wage and Salary Employment Declines Past Four Years
(annual average in thousands)



Source: Bureau of Labor Statistics.

Michigan manufacturing employment has declined even more sharply. Since June 2000, Michigan manufacturing employment has fallen by more than 200,000 jobs. Michigan has lost one out of every five manufacturing jobs it had at the state's employment peak.

Unemployment Rate

Michigan's annual average unemployment rate for 2004 is 7.1 percent, matching the state's 2003 unemployment rate. In March, the state's unemployment rate fell to 6.9 percent, down from 7.4 percent in February and 7.1 percent from March 2004. The state's unemployment rate remains substantially above the lows of around 3.0 percent achieved during the expansion of the late 1990s.

Personal Income

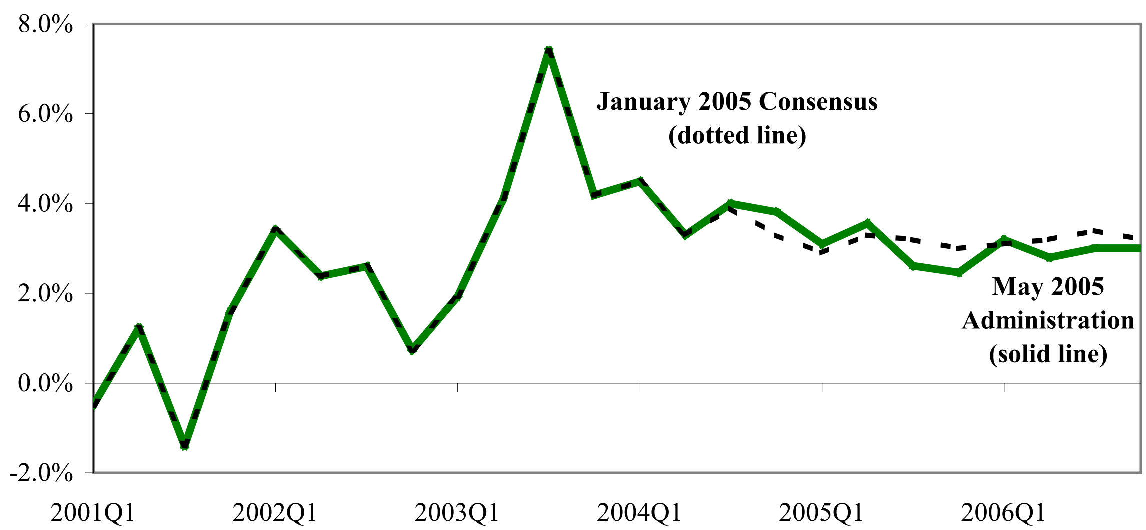
Based on preliminary estimates, Michigan's personal income rose 2.8 percent in 2004; wages and salaries grew 1.9 percent. Wages and salaries grew 2.6 percent year-over-year in the fourth quarter of 2004. Overall personal income grew 3.0 percent in the fourth quarter.

2005 and 2006 U.S. Economic Outlook

Summary

Real GDP growth is forecast to slow from 4.4 percent growth in 2004 to 3.3 percent growth in 2005 and 2.9 percent growth in 2006.

Real GDP Forecast Comparisons

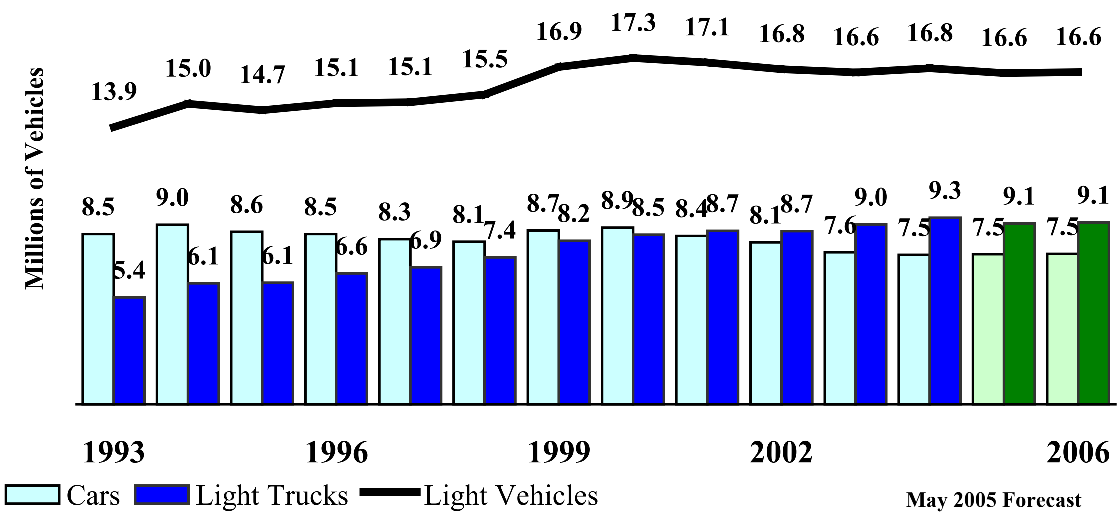


Business investment is forecast to grow 6.4 percent in 2005 and rise 7.0 percent in 2006, down from 10.6 percent growth in 2004. Investment growth slows as interest rates increase and energy prices remain high. Consumption is forecast to rise 3.5 percent in 2005 and 3.4 percent in 2006. A stronger labor market will help consumer spending and offset the impact of higher interest rates. Government spending growth is expected to slow in 2005 and 2006. Federal defense spending growth will remain strong in 2005 before slowing in 2006. State and local government spending will increase, albeit at a weak rate in 2005, as some individual state economies make stronger recoveries. Net exports are forecast to fall in 2005 but rise slightly in 2006. Light vehicle sales are projected to decline slightly from 16.8 million units in 2004 with projected sales of 16.6 million units in both 2005 and 2006.

Inflation will remain moderate throughout the forecast horizon. As measured by the consumer price index (CPI), consumer prices are expected to rise 2.6 percent in 2005 and 2.7 percent in 2006. Interest rates are forecast to rise as the Federal Reserve continues to raise the target federal funds rate. Between 2004 and 2006, the 3-month Treasury bill rate is forecast to increase from 1.4 percent to 4.7 percent while the Aaa corporate bond rate rises, but less so, rising from 5.6 percent to 6.6 percent.

U.S. employment is forecast to rise in 2005 and 2006 with gains projected throughout the forecast horizon. The U.S. unemployment rate is expected to fall slightly from 5.5 percent in 2004 to 5.3 percent in 2005 and remain at 5.3 percent in 2006.

Motor Vehicle Sales Stable



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, May 2005.

<u>Assumptions</u>

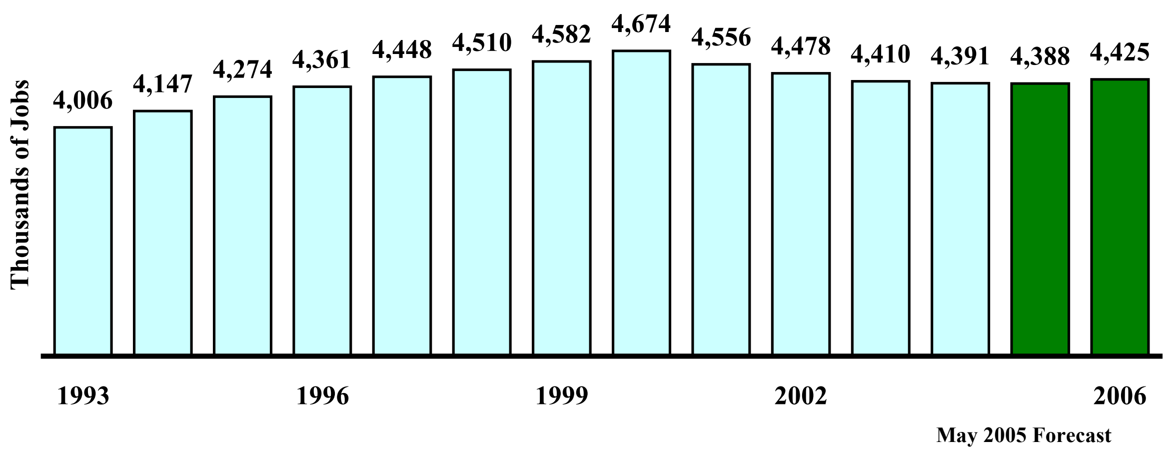
Oil prices are projected to decline only slightly over the forecast horizon with prices hovering around $50 a barrel. With stronger employment readings and commodity price pressures, the Federal Reserve is assumed to continue to raise the target federal funds rate. The target federal funds rate is projected to rise to 4.25 percent by the end of 2005 and 5.50 percent by the end of 2006.

The household savings rate is forecast to stay around 1.0 percent throughout the forecast. Stock prices are expected to post modest gains over the forecast horizon with prices flat through the third quarter of 2005 and then increasing by 1.0 percent a quarter following that.

2005 and 2006 Michigan Economic Outlook

Michigan employment is forecast to decline slightly in 2005, marking the fifth straight year in which state employment declined. Employment is then expected to increase 0.8 percent in 2006. Continued declines in manufacturing employment will constrain overall Michigan employment. In 2005, employment is forecast to increase an average of 2,000 jobs per quarter and increase an average of 10,000 per quarter in 2006. Michigan's unemployment rate is forecast to rise slightly in 2005 to 7.3 percent before declining to 7.0 percent in 2006.

Michigan Wage and Salary Employment



Source: Michigan Department of Labor and Economic Growth, U.S. Bureau of Labor Statistics and Administration Forecast, May 2005.

Wage and salary income is projected to rise 3.4 percent in 2005. In 2006, wage and salary income is projected to increase 4.3 percent as employment increases. Michigan personal income is forecast to rise 4.5 percent in 2005 and 5.4 percent in 2006.

Inflation, as measured by the Detroit CPI, is forecast to rise 2.1 percent in 2005 and 2.3 percent in 2006. As a result, real Michigan personal income (inflation adjusted) is expected to rise 2.7 percent in 2005 and 3.0 percent in 2006.

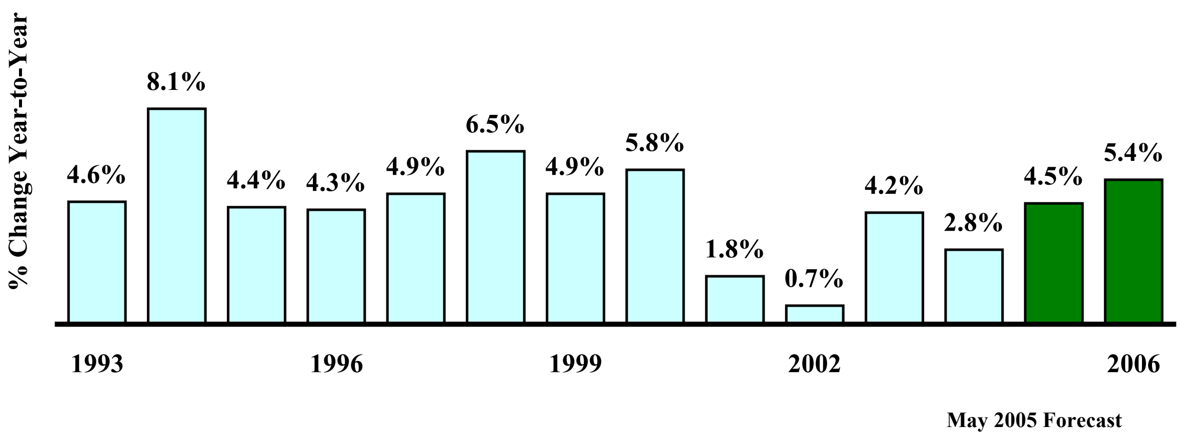
Table 1

Adminstration Economic Forecast

May 2005

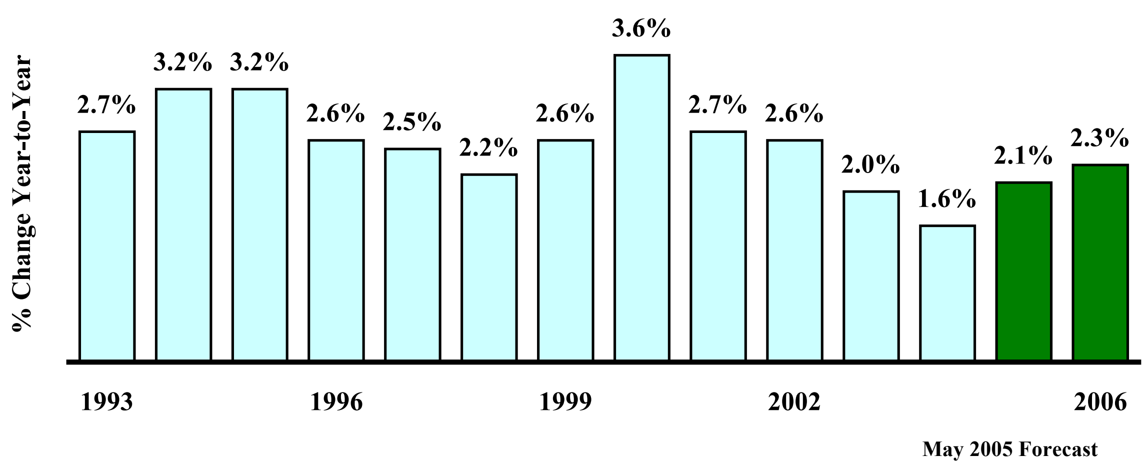
	Calendar 2003 Actual	Calendar 2004 Forecast	Percent Change from Prior Year	Calendar 2005 Forecast	Percent Change from Prior Year	Calendar 2006 Forecast	Percent Change from Prior Year
United States							
Real Gross Domestic Product (Billions of Chained 2000 Dollars)	$10,381	$10,842	4.4%	$11,204	3.3%	$11,529	2.9%
Implicit Price Deflator GDP (2000 = 100)	106.0	108.2	2.1%	110.6	2.2%	113.4	2.6%
Consumer Price Index (1982-84 = 100)	184.0	189.0	2.7%	194.0	2.6%	199.2	2.7%
Personal Consumption Deflator (2000 = 100)	105.5	107.8	2.2%	110.1	2.1%	112.6	2.3%
3-month Treasury Bills Interest Rate (percent)	1.0	1.4		3.3		4.7	
Aaa Corporate Bonds Interest Rate (percent)	5.7	5.6		5.7		6.6	
Unemployment Rate - Civilian (percent)	6.0	5.5		5.3		5.3	
Light Vehicle Sales (millions of units)	16.6	16.8	1.2%	16.6	-1.5%	16.6	0.1%
Passenger Car Sales (millions of units)	7.6	7.5	-1.6%	7.5	0.3%	7.5	0.2%
Light Truck Sales (millions of units)	9.0	9.3	3.7%	9.1	-3.0%	9.1	0.4%
Import Share of Light Vehicles (percent)	19.9	20.2		20.9		21.7	
Michigan							
Wage and Salary Employment (thousands)	4,410	4,391	-0.4%	4,388	-0.1%	4,425	0.8%
Unemployment Rate (percent)	7.1	7.1		7.3		7.0	
Personal Income (millions of dollars)	$314,346	$323,142	2.8%	$337,842	4.5%	$356,183	5.4%
Real Personal Income (millions of 1982-84 dollars)	$172,244	$173,816	0.9%	$178,469	2.7%	$183,884	3.0%
Wages and Salaries (millions of dollars)	$176,645	$180,058	1.9%	$186,119	3.4%	$194,131	4.3%
Detroit Consumer Price Index (1982-84 = 100)	182.5	185.4	1.6%	189.3	2.1%	193.7	2.3%
Detroit CPI Fiscal Year (1982-84 = 100)	182.0	184.4	1.3%	188.4	2.2%	192.7	2.3%

Michigan Personal Income Growth Stronger in 2005



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, May 2005.

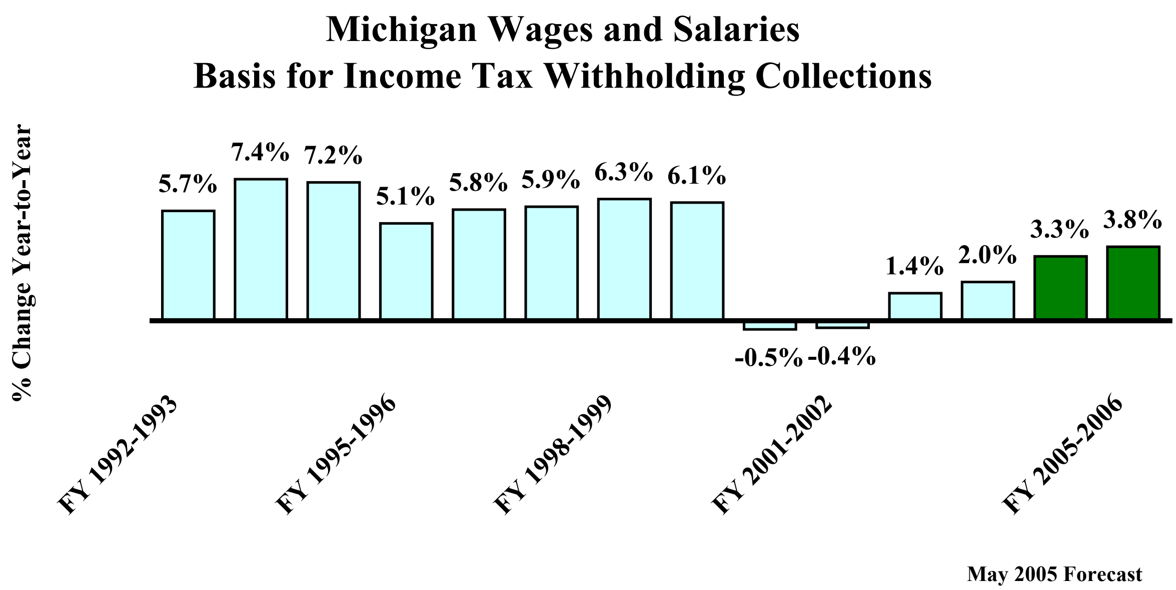
Inflation Rate Remains Low
Detroit CPI



Source: U.S. Bureau of Labor Statistics and Administration Forecast, May 2005.

Fiscal Year Economics

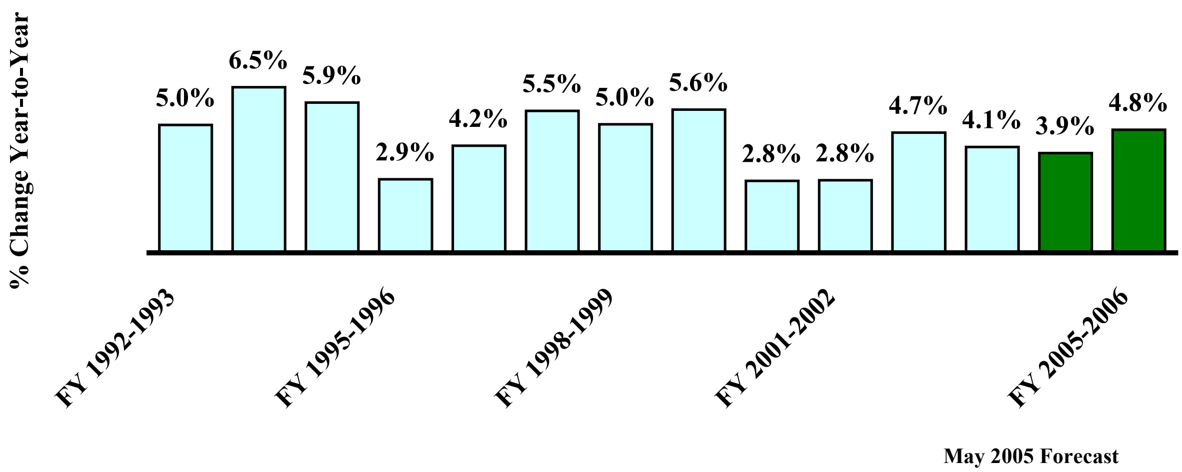
Michigan's largest taxes are the individual income tax, which includes refunds, ($6.1 billion) and sales and use taxes ($8.4 billion). Income tax withholding is the largest income tax component. Withholding ($6.6 billion) is most affected by growth in wages and salaries. Michigan wages and salaries are expected to grow 3.3 percent in FY 2005 and to grow 3.8 percent in FY 2006 up from 2.0 percent growth in FY 2004. However, the FY 2005 and FY 2006 forecasted increases are substantially slower than growth reported through much of the 1990s.



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, May 2005.

Sales and use taxes depend primarily on Michigan disposable (after tax) income and inflation. Disposable income is expected to rise 3.9 percent in FY 2005 and to increase 4.8 percent in FY 2006. The inflation rate is forecast to rise 2.2 percent in FY 2005 and is expected to increase 2.3 percent in FY 2006.

Michigan Disposable Income
Basis for Sales and Use Tax Collections



Source: Research Seminar in Quantitative Economics, University of Michigan, and Administration Forecast, May 2005.

Forecast Risks

Current oil prices are supported by two factors: (a) Given strained capacity and geopolitical concerns, the current oil price includes a risk premium. (b) Continued strong international demand for oil, particularly from China, continues to support a higher price. Given this, there is both a downside and an upside risk to the assumption that oil prices remain around $50 a barrel. Geopolitical concerns may lessen/intensify, thereby reducing/increasing oil prices. Recent high oil prices may slow the world economy leading to a reduction in the demand for oil. A lower/higher oil price will help boost/retard domestic growth.

The baseline forecast assumes that the value of the dollar will continue to fall in an orderly fashion. However, if international confidence in the dollar declines dramatically, the value of the dollar may fall sharply. A plummeting dollar could roil financial markets, sharply curtailing both consumption and investment and thus slow economic growth sharply. A collapsing dollar would also put upward pressure on inflation and possibly lead to still higher interest rates, which would further retard growth.

The forecast uses a five-country trade weighted growth rate including Japan, United Kingdom, Germany, Canada and Mexico. Thus, the variable does not include many faster growing countries that are becoming more significant trading partners. Given this, there is an upside risk regarding rest of world growth. On the other hand, higher oil and other commodity prices could retard rest of world growth.

Firms' increased pricing power, increased obsolescence of current capacity, higher commodity prices, and rising health care and pension costs may lead to higher inflation than the baseline forecast projects. This higher inflation rate may crimp consumption and investment spending – especially if accompanied by even more aggressive inflation fighting on the part of the Federal Reserve.

The baseline forecast assumes that the travel and trade sectors grow more slowly than expected given U.S. economic growth. However, the forecast does not assume that the manufacturing sector grows substantially more slowly than U.S. economic growth would project. Given Michigan's manufacturing mix, it is very possible that manufacturing growth would grow substantially more slowly than U.S. economic growth itself would imply. This would retard Michigan economic growth, employment and income growth.

If business investment is above projected levels, economic growth may be more than forecast. For the Michigan economy, Big Three market share is important. Sharp declines in market share would affect the Michigan economy adversely compared to other states. Similarly, faster/slower productivity growth may decrease/increase employment. Faster/slower inventory investment will increase/decrease economic growth.

ADMINISTRATION REVENUE ESTIMATES

May 19, 2005

Revenue Estimate Overview

The revenue estimates presented in this section consist of baseline revenues, revenue adjustments, and net revenues. Baseline revenues provide an estimate of the effects of the economy on tax revenues. For these estimates, FY 2004 is the base year. Any non-economic changes to the taxes occurring in FY 2005 and FY 2006 are not included in the baseline estimates. Non-economic changes are referred to in the tables as "tax adjustments." The net revenue estimates are the baseline revenues adjusted for tax adjustments.

This treatment of revenue is best illustrated with an example. Suppose tax revenues are $10.0 billion in a given year, and that based on the economic forecast, revenues are expected to grow by 5.0 percent per year. Baseline revenue would be $10.0 billion in Year 1, $10.5 billion in Year 2, and $11.0 billion in Year 3. Assume a rate cut is in place that would reduce revenues by $100 million in Year 1, $200 million in Year 2, and $300 million in Year 3. If Year 1 is the base year, the revenue adjustments for Year 1 would be $0 since the tax cut for this year is included in the base. The revenue adjustments for Year 2 would be $100 million, and the revenue adjustments for Year 3 would be $200 million, since the revenue adjustments are compared to the base year.

In the example above, the baseline revenues would be $10.0 billion, $10.5 billion, and $11.0 billion, for Years 1 through 3, respectively. The revenue adjustments would be $0 in Year 1, $100 million in Year 2, and $200 million in Year 3. The $200 million in Year 3 represents the tax cuts since Year 1. Net revenue would be $10.0 billion in Year 1, $10.4 billion in Year 2, and $10.8 billion in Year 3.

The revenue figures presented below are on a Consensus basis. Generally speaking, the Consensus estimates do not include certain one-time budget measures, such as withdrawals from the Budget Stabilization Fund, the sale of buildings, etc. The figures also assume the full statutory amount for revenue sharing payments. In addition, the estimates only include enacted legislation and do not include the effects of any proposed changes. The School Aid Fund estimates consist of taxes plus the transfer from the State Lottery Fund.

FY 2004 Revenue Review

FY 2004 GF-GP revenue totaled $8,041.8 million on a Consensus basis, a 1.0 percent increase over FY 2003. This was the first increase in GF-GP revenues since FY 2000. SAF revenue totaled $10,615.5 million, a 0.9 percent decline compared to FY 2003 (See Table 2). The change in the timing of the state education tax payments increased FY 2003 SAF revenues, and as a result reduced the FY 2004 SAF growth rate. Excluding the state education tax shift, FY 2004 SAF revenues were 3.4 percent higher than FY 2003.

Table 2

FY 2003-04 Administration Revenue Estimates

(millions)

	Actual	
	Amount	**Growth**
General Fund - General Purpose		
Baseline Revenue	$7,992.6	
Tax Cut Adjustments	$49.3	
Net Resources	$8,041.8	1.0%
School Aid Fund		
Baseline Revenue	$10,533.5	
Tax Cut Adjustments	$82.0	
Net Resources	$10,615.5	-0.9%
Combined		
Baseline Revenue	$18,526.1	
Tax Cut Adjustments	$131.3	
Net Resources	$18,657.4	-0.1%

Prepared By: Economic and Revenue Forecasting Division, Michigan Department of Treasury

FY 2005 Revenue Outlook

Baseline revenue growth improves in FY 2005 with the improving economy. FY 2005 GF-GP revenue is expected to be $7,894.2 million, a 2.1 percent baseline increase, and a 1.8 percent reduction after tax adjustments. Net GF-GP growth is slowed by a number of factors including the income tax rate cut, the continued phase-out of the state's estate tax, and the shift of some tobacco revenues to the Medicaid Trust Fund. The FY 2005 estimate is $24.4 million above the January 2005 Consensus estimate. SAF revenue is forecast to be $10,885.7 million, representing 3.3 percent SAF baseline growth and 2.5 percent growth after tax adjustments. The FY 2005 SAF estimate is $6.9 million higher than the January Consensus estimate (See Table 3).

Table 3

FY 2004-05 Administration Revenue Estimates

(millions)

	Consensus January 13, 2005		Administration May 19, 2005		
	Amount	**Growth**	**Amount**	**Growth**	**Change**
General Fund - General Purpose					
Baseline Revenue	$8,123.6	1.6%	$8,163.8	2.1%	
Tax Cut Adjustments	($253.8)		($269.5)		
Net Resources	$7,869.8	-2.1%	$7,894.2	-1.8%	$24.4
School Aid Fund					
Baseline Revenue	$10,868.8	3.2%	$10,885.9	3.3%	
Tax Cut Adjustments	$10.0		($0.2)		
Net Resources	$10,878.8	2.5%	$10,885.7	2.5%	$6.9
Combined					
Baseline Revenue	$18,992.4	2.5%	$19,049.7	2.8%	
Tax Cut Adjustments	($243.8)		($269.8)		
Net Resources	$18,748.6	0.5%	$18,779.9	0.7%	$31.3

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FY 2006 Revenue Outlook

Revenue growth strengthens in FY 2006 as the economic recovery in Michigan takes hold. FY 2006 GF-GP revenue is expected to be $8,156.0 million, a 2.7 percent baseline increase, and a 3.3 percent increase after tax adjustments. Net GF-GP growth is increased in FY 2006 by the shift of some tobacco tax revenues from the Medicaid Trust Fund back to GF-GP. The FY 2006 GF-GP estimate is essentially unchanged from the January 2005 Consensus estimate. SAF revenue is forecast to be $11,291.7 million, representing 3.6 percent SAF baseline growth and 3.7 percent growth after tax adjustments. The FY 2006 SAF estimate is $9.2 million below the January 2005 Consensus estimate (see Table 4).

Table 4

FY 2005-06 Administration Revenue Estimates

(millions)

	Consensus January 13, 2005		Administration May 19, 2005		
	Amount	**Growth**	**Amount**	**Growth**	**Change**
General Fund - General Purpose					
Baseline Revenue	$8,374.5	3.1%	$8,388.0	2.7%	
Tax Cut Adjustments	($218.3)		($232.1)		
Net Resources	$8,156.2	3.6%	$8,156.0	3.3%	($0.2)
School Aid Fund					
Baseline Revenue	$11,284.1	3.8%	$11,279.1	3.6%	
Tax Cut Adjustments	$16.8		$12.6		
Net Resources	$11,300.9	3.9%	$11,291.7	3.7%	($9.2)
Combined					
Baseline Revenue	$19,658.6	3.5%	$19,667.1	3.2%	
Tax Cut Adjustments	($201.5)		($219.5)		
Net Resources	$19,457.1	3.8%	$19,447.7	3.6%	($9.4)

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Constitutional Revenue Limit

Article IX, Section 26, of the Michigan Constitution establishes a limit on the amount of revenue state government can collect in any given fiscal year. The revenue limit for a given fiscal year is equal to 9.49 percent of the state's personal income for the calendar year prior to the year in which the fiscal year begins. FY 2003 revenue is compared to CY 2001 personal income. If revenues exceed the limit by less than 1 percent, the state may deposit the excess into the Budget Stabilization Fund (BSF). If the revenues exceed the limit by more than 1 percent, the excess revenue is refunded to taxpayers via the income and single business taxes.

FY 2003 revenues were $4.2 billion below the revenue limit. State revenues will be well below the limit for FY 2004 through FY 2006 due to the effects of tax cuts and the economic slowdown on the state's revenue stream. FY 2004 revenues are expected to be $4.7 billion below the limit, FY 2005 revenues $5.7 billion below the limit, and FY 2006 revenues $5.7 billion below the limit (See Table 5).

Table 5

Administration Constitutional Revenue Limit Calculation

(millions)

	FY 2003	FY 2004	FY 2005	FY 2006
	Actual Mar 2004	Admin May 2005	Admin May 2005	Admin May 2005
Revenue Subject to Limit	$24,061.6	$24,082.6	$24,180.9	$24,983.0
Revenue Limit	**CY 2001**	**CY 2002**	**CY 2003**	**CY 2004**
Personal Income	$297,609	$303,745	$314,460	$323,142
Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	$28,243.1	$28,825.4	$29,842.2	$30,666.2
Amount Under (Over) Limit	**$4,181.5**	**$4,742.8**	**$5,661.3**	**$5,683.2**

Budget Stabilization Fund Calculation

The Management and Budget Act contains provisions for calculating a recommended deposit or withdrawal from the BSF. The calculation looks at personal income net of transfer payments. The net personal income figure is adjusted for inflation. The change in this figure for the calendar year determines whether a pay-in or pay-out is dictated. If the formula calls for a deposit into the BSF, the deposit is made in the next fiscal year. If the formula calls for a withdrawal, the withdrawal is made during the current fiscal year.

If real personal income grows by more than 2 percent in a given calendar year, the fraction of income growth over 2 percent is multiplied by the current fiscal year's GF-GP revenue to determine the pay-in for the next fiscal year. If real personal income declines, the percentage deficiency under zero is multiplied by the current fiscal year's GF-GP revenue to determine the withdrawal available for the current fiscal year. If the change in real personal income is between 0 and 2 percent, no pay-in or withdrawal is indicated.

Real calendar year personal income for Michigan is expected to increase by 1.3 percent in 2005. Therefore, no pay-in is called for in FY 2006 (See Table 6).

Table 6

Budget and Economic Stabilization Fund Calculation Based on CY 2005 Personal Income Growth Administration Calculation

	CY 2004	CY 2005
Michigan Personal Income	$ 323,142 [1]	$ 337,845 [2]
less Transfer Payments	$ 49,101 [1]	$ 52,106 [2]
Income Net of Transfers	$ 274,041	$ 285,738
Detroit CPI	1.837 [3]	1.890 [4]
for 12 months ending	(June 2004)	(June 2005)
Real Adjusted Michigan Personal Income	$ 149,178	$ 151,163
Change in Real Adjusted Personal Income		1.3%
Between 0 and 2%		0.0%
GF-GP Revenue Fiscal Year 2004-2005		$ 7,894.2

	FY 2005-2006
BSF Pay-In Calculated for FY 2006	NO PAY-IN INDICATED

Notes:

[1] Personal Income and Transfer Payments, Bureau of Economic Analysis, March 2005.

[2] Personal Income and Transfer Payments, Administration Forecast, May 2005.

[3] Detroit Consumer Price Index, Average of 6 monthly values reported by BLS for each 12-month period.

[4] Detroit Consumer Price Index, Administration estimate.

School Aid Fund Revenue Adjustment Factor

The School Aid Fund (SAF) revenue adjustment factor for the next fiscal year is calculated by dividing the sum of current year and subsequent year SAF revenue by the sum of current year and prior year SAF revenue. For example, the FY 2006 SAF revenue adjustment factor is calculated by dividing the sum of FY 2005 and FY 2006 SAF revenue by the sum of FY 2004 and FY 2005 SAF revenue. The SAF revenue totals are adjusted for any change in the rate and base of the SAF taxes. The year for which the adjustment factor is being calculated is used as the base year for any tax adjustments. For FY 2006, the SAF revenue adjustment factor is calculated to be 1.0348 (See Table 7).

Table 7

Administration School Aid Revenue Adjustment Factor

For Fiscal Year FY 2006

	FY 2004	FY 2005	FY 2006
Baseline SAF Revenue	$10,533.5	$10,885.9	$11,279.1
Balance Sheet Adjustments	$82.0	($0.2)	$12.6
Net SAF Estimates	$10,615.5	$10,885.7	$11,291.7
Adjustments to FY 2006 Base Year	($69.4)	$12.8	$0.0
Baseline Revenue on a FY 2006 Base	$10,546.1	$10,898.5	$11,291.7

School Aid Fund Revenue Adjustment Calculation for FY 2005-06

Sum of FY 2004 & FY 2005	$10,546.1	+	$10,898.5	=	$21,444.7
Sum of FY 2005 & FY 2006	$10,898.5	+	$11,291.7	=	$22,190.2

FY 2006 Revenue Adjustment Factor	**1.0348**

Note: Adjustment factor is calculated off a FY 2006 base year.

Revenue Detail

The estimated tax and revenue totals include the effects of all enacted tax changes except sales tax savings resulting from reductions in revenue sharing payments to local units. The revenue totals by tax are presented separately for GF-GP and for the SAF (See Tables 8 and 9). Tax totals for the income, sales, use, and tobacco taxes for all funds are also included (See Table 10).

Table 8

Administration General Fund General Purpose Revenue Detail

(millions)

	FY 2004		FY 2005		FY 2006	
	Amount	**Growth**	**Amount**	**Growth**	**Amount**	**Growth**
GF-GP Tax Amounts						
Income Tax	$3,977.7	0.4%	$3,983.6	0.2%	$4,129.6	3.7%
Sales	$102.2	60.3%	$118.8	16.3%	$114.2	-3.8%
Use	$877.4	7.1%	$926.2	5.6%	$963.6	4.0%
Cigarette	$242.7	-16.1%	$119.0	-51.0%	$231.1	94.3%
Beer & Wine	$51.5	0.8%	$52.0	1.0%	$52.5	1.0%
Liquor Specific	$33.0	6.1%	$33.5	1.5%	$34.0	1.5%
Single Business Tax	$1,827.6	-0.8%	$1,820.7	-0.4%	$1,870.2	2.7%
Insurance Co. Premium	$230.3	-0.3%	$233.3	1.3%	$237.0	1.6%
Telephone & Telegraph	$101.3	-18.4%	$95.3	-5.9%	$79.3	-16.8%
Inheritance Estate	$75.5	-23.4%	$30.0	-60.3%	$6.0	-80.0%
Intangibles	$0.1	0.0%	$0.0	0.0%	$0.0	0.0%
Casino Wagering	$3.2	NA	$41.8	1206.3%	$42.6	0.0%
Horse Racing	$2.0	0.0%	$0.0	0.0%	$0.0	0.0%
GF-GP Other Taxes	$24.0	-54.6%	$28.5	18.8%	$28.0	-1.8%
Total GF-GP Taxes	$7,605.5	-0.1%	$7,544.6	-0.8%	$7,844.2	4.0%
GF-GP Non-Tax Revenue						
Federal Aid	$66.1	40.0%	$35.0	-47.0%	$35.0	0.0%
From Local Agencies	$2.9	222.2%	$2.0	-31.0%	$2.0	0.0%
From Services	$17.8	109.4%	$18.0	1.1%	$18.0	0.0%
From Licenses & Permit	$55.2	226.6%	$54.0	-2.2%	$54.0	0.0%
Miscellaneous	$76.1	-23.9%	$118.3	55.5%	$129.5	9.5%
Short Term Note Int.	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Interfund Interest	($22.2)	66.9%	($73.0)	228.8%	($100.0)	37.0%
Liquor Purchase	$139.4	9.9%	$133.0	-4.6%	$134.0	0.8%
Charitable Games	$12.2	8.9%	$11.5	-5.7%	$11.5	0.0%
Transfer From Escheats	$89.0	55.3%	$50.8	-42.9%	$27.8	-45.3%
Other Non Tax	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Total Non Tax	$436.5	25.6%	$349.6	-19.9%	$311.8	-10.8%
Total GF-GP Revenue	$8,041.8	1.0%	$7,894.2	-1.8%	$8,156.0	3.3%

Table 9

Administration School Aid Fund Revenue Detail

	FY 2004		FY 2005		FY 2006	
	Amount	Growth	Amount	Growth	Amount	Growth
School Aid Fund						
Income Tax	$1,893.4	2.5%	$1,979.2	4.5%	$2,056.3	3.9%
Sales Tax	$4,716.7	0.8%	$4,852.4	2.9%	$5,047.1	4.0%
Use Tax	$439.1	7.0%	$463.1	5.5%	$481.9	4.0%
Liquor Excise Tax	$32.4	5.9%	$33.5	3.4%	$34.0	1.5%
Cigarette	$469.3	-0.5%	$461.0	-1.8%	$453.4	-1.7%
Other Tobacco	$16.0	-9.7%	$16.0	0.0%	$16.0	0.0%
State Ed Prop Tax	$1,824.5	-14.2%	$1,856.6	1.8%	$1,958.8	5.5%
Real Estate Transfer	$317.5	15.2%	$322.0	1.4%	$324.0	0.6%
Ind and Comm Facilities	$150.2	-6.8%	$141.5	-5.8%	$141.0	-0.4%
Casino (45% of 18%)	$95.8	5.4%	$96.7	0.9%	$98.5	1.9%
Commercial Forest	$2.8	0.0%	$2.8	0.0%	$2.8	0.0%
Other Specific Taxes	$13.0	10.2%	$12.0	-7.7%	$12.0	0.0%
Subtotal Taxes	$9,970.7	-1.6%	$10,236.8	2.7%	$10,625.7	3.8%
Lottery Transfer	$644.9	10.1%	$649.0	0.6%	$665.9	2.6%
Total SAF Revenue	$10,615.5	-0.9%	$10,885.7	2.5%	$11,291.7	3.7%

Table 10

Administration Major Tax Totals

Major Tax Totals (Includes all Funds)						
Income Tax	$5,872.5	1.1%	$5,964.3	1.6%	$6,187.4	3.7%
Sales Tax	$6,473.5	0.8%	$6,662.8	2.9%	$6,930.0	4.0%
Use Tax	$1,316.5	7.0%	$1,389.3	5.5%	$1,445.5	4.0%
Cigarette and Tobacco	$993.3	11.5%	$1,179.2	18.7%	$1,160.5	-1.6%